

GAO

Report to the Director, Defense  
Contract Audit Agency

August 1991

# CONTRACT PRICING

## Defense Contract Audit Agency's Estimating Reports Can Be Improved



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National Security and  
International Affairs Division

B-242680

August 1, 1991

Mr. William H. Reed  
Director, Defense Contract Audit Agency

Dear Mr. Reed:

On May 9, 1990, the Chairman, Senate Committee on Governmental Affairs, requested that we evaluate the adequacy of controls for preventing fraud, waste, and mismanagement in Department of Defense (DOD) subcontracts.<sup>1</sup> In response, we evaluated 101 reports issued by the Defense Contract Audit Agency (DCAA) dealing with defense contractor cost-estimating systems.<sup>2</sup> This report discusses specific ways to enhance such DCAA reports and make them more consistent with the agency's reporting procedures.

## Background

In March 1988, DOD revised the Defense Federal Acquisition Regulation Supplement (DFARS) 215.811 to require major contractors to establish, maintain, and disclose adequate cost-estimating systems. DCAA plays a key role in assessing the adequacy of contractor estimating systems. DFARS now requires DCAA, along with contract administration personnel, to periodically review contractors' estimating systems. Accordingly, DCAA reports are instrumental in correcting significant and widespread estimating deficiencies.

DCAA is required to document the results of its cost-estimating system reviews in reports to the appropriate administrative contracting officers. Under DCAA's guidance, cost-estimating system reports should demonstrate the potential cost impact of identified deficiencies. DCAA's audit manual indicates that estimating system reports should include convincing examples that show the significance of the deficiency and how the government was harmed. According to DFARS, when DCAA finds significant estimating system deficiencies, its reports shall recommend disapproval of all or portions of contractors' systems.

<sup>1</sup>For this report, "subcontract" refers to all purchases from any supplier, distributor, vendor, or firm furnishing materials, supplies, or services to DOD prime contractors or subcontractors.

<sup>2</sup>Contract Pricing: Defense Subcontract Cost-Estimating Problems Are Chronic and Widespread (GAO/NSIAD-91-157, Mar. 28, 1991.)

DCAA notified its auditors of these revised regulations in May 1988. In July 1989, DCAA also revised its contract audit manual to include the new reporting requirements.

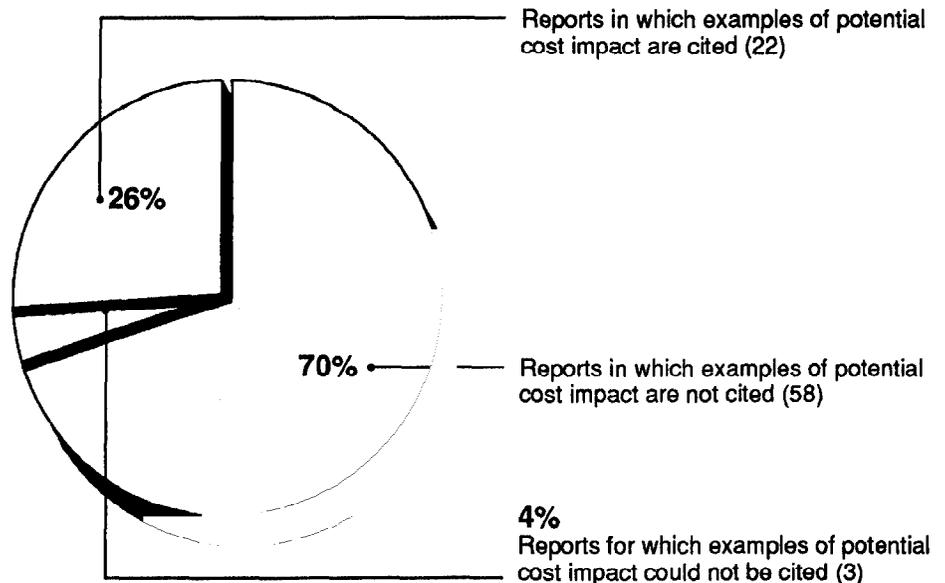
## Results in Brief

The DCAA estimating system reports that identified subcontract-estimating deficiencies did not always demonstrate and emphasize to administrative contracting officers and contractors the need to correct these deficiencies. This shortcoming occurred because the reports were often not prepared in accordance with two of the agency's reporting procedures. Specifically, many DCAA reports did not illustrate the potential cost impact of the identified deficiencies or contain appropriate recommendations for disapproving inadequate systems.

## Potential Cost Impact of Cited Deficiencies Was Not Demonstrated

Although uncorrected subcontract-estimating deficiencies were identified in 83 of the 101 DCAA reports we reviewed, examples of cost impact were generally not cited. Of the 83 reports, 58 (or 70 percent) did not include examples of the potential cost impact (see fig. 1). The 58 reports cited 227 uncorrected subcontract-estimating deficiencies.

**Figure 1: Extent to Which DCAA Reports Included Examples of Potential Cost Impact**



Three reports could not cite a cost impact because they identified only deficiencies in subcontract policies and procedures for which examples of cost impact would not be appropriate.

Source: Our analysis of DCAA's reports.

The following example illustrates a case in which a report did not show the potential cost impact of a deficiency even though examples were available. In a September 1989 report, a contractor was cited for not providing a subcontract cost or price analysis as required by regulation. The contractor had been cited for the same deficiency in two previous reports issued by DCAA in 1987 and 1988. However, none of the reports included examples of the potential cost impact of the deficiency.

Our review indicated that, in at least some cases, examples showing the potential cost impact were readily available. Ten proposal review reports,<sup>3</sup> issued by the DCAA field audit office between August 1988 and June 1989, questioned about \$44 million in subcontract costs because the contractor had not conducted required subcontract cost or price analyses. In February 1991, 43 months after the deficiency was initially reported, DCAA auditors told us that the contractor's failure to provide subcontract cost or price analyses was still a significant deficiency. Without citing such examples, the report did not comply with the audit manual requirement and did not demonstrate the potential impact of the deficiency as clearly as it could have.

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## Many Reports Did Not Contain Required Recommendations

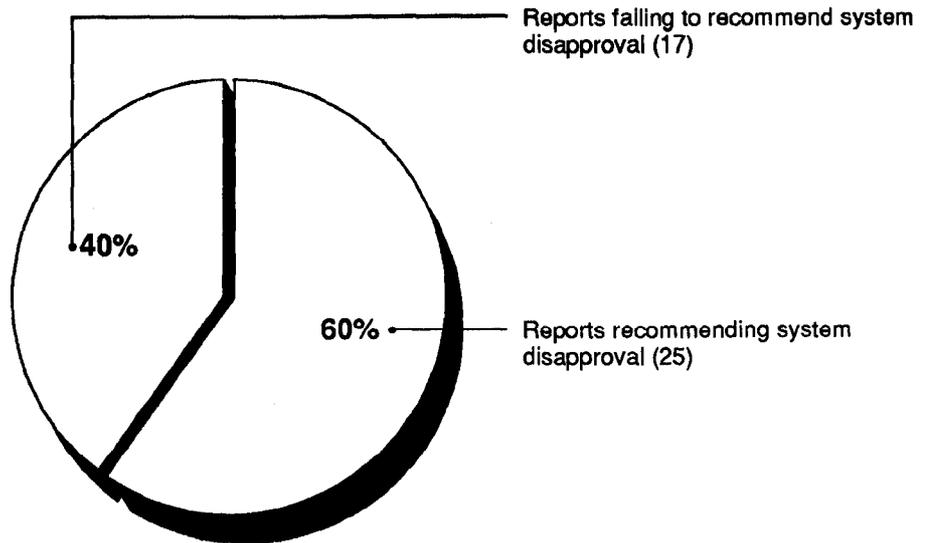
DFARS requires that DCAA recommend disapproval of all, or portions of, an estimating system if DCAA identifies significant estimating deficiencies. However, many DCAA reports did not comply with this requirement. Forty-two reports with significant subcontract-estimating deficiencies concluded that contractor systems were totally inadequate or inadequate in some respects. Although in 25 of these cases, the reports contained recommendations to disapprove the contractor's estimating systems, the other 17 reports did not include the required recommendations (see fig. 2). We identified similar problems in an earlier review of DCAA estimating system reports.<sup>4</sup>

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<sup>3</sup>Proposal reviews are DCAA evaluations of the adequacy of the cost or pricing data and cost estimates included in the contractors' proposals.

<sup>4</sup>Contract Pricing: Implementation of Cost-Estimating Regulations (GAO/NSIAD-90-290, Sept. 28, 1990)

**Figure 2: Extent to Which Reports Identifying Inadequate Estimating Systems Recommended System Disapproval**



Source: Our analysis of DCAA's reports.

Eight of the 17 reports were issued after the expanded guidance that incorporated the requirement for recommending system disapproval was added to the audit manual. However, those reports did not recommend disapproval of inadequate systems. As an example, a September 1989 report stated that a contractor's estimating system methods and procedures had not improved to any significant extent and were not adequate to ensure that proposals and final certified contract prices were based on accurate, complete, and current cost or pricing data. The report noted, among other things, that the contractor's written estimating policies and procedures were incomplete, and that its direct material cost estimates were inadequate. However, the report did not recommend disapproval of the system.

### DCAA Actions to Ensure Reporting Guidelines Are Followed

When we discussed the results of our work with DCAA officials, they told us that increased emphasis had been placed on ensuring that appropriate recommendations were included in estimating-system reports when significant estimating deficiencies were identified. For example, in February 1991, DCAA issued a memo to its Regional Directors emphasizing the need to follow reporting requirements for making recommendations when significant estimating deficiencies were identified. Also, DCAA headquarters officials have been monitoring all estimating system

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survey and follow-up reports issued after February 12, 1991, to ensure that they comply with the agency's audit manual.

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## Recommendations

So that DCAA's audit reports adequately reflect the need to correct estimating deficiencies, we recommend that you emphasize to DCAA's field audit offices the importance of providing examples of cost impact to demonstrate the significance of the deficiencies cited. We also recommend that you monitor estimating system survey and follow-up reports until improvements are noted in field audit offices' compliance with regulatory requirements for recommending disapproval of contractor systems containing significant estimating deficiencies.

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## Scope and Methodology

We assessed DCAA's cost-estimating system reports issued by field audit offices in the Western and Mid-Atlantic regions between March 1989 and February 1990. The reports covered contract proposals submitted by contractors and evaluated by DCAA after DOD had added new requirements to the DFARS for cost-estimating systems in March 1988. Our analysis was based on 101 reports in which DCAA had reviewed major elements of each contractor's estimating system. These elements included subcontracting, materials, overhead, labor, and written policies and procedures. As part of our analysis, we assessed whether DCAA reports followed certain reporting requirements. We also visited four DCAA offices—two in each region—and interviewed responsible DCAA audit staff.

We conducted our review between May 1990 and February 1991 in accordance with generally accepted government auditing standards.

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Appendix I identifies (by GAO control number and DCAA report number) 83 reports in which subcontract-estimating deficiencies were identified. These reports are grouped according to whether they cited examples of the potential cost of the deficiencies. The 17 reports that concluded that an estimating system was inadequate but did not include recommendations for system disapproval are listed in appendix II.

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on this recommendation to the Senate Committee on Governmental Affairs and the House Committee on Governmental Operations not later than 60 days after the date of the report and to the House and Senate Committees on

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Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this report are being sent to the Chairman, Senate Committee on Governmental Affairs, the Secretary of Defense, and the Commander, Defense Contract Management Command. We will also make copies available to other interested parties upon request.

Please contact me at (202) 275-8400 if you or your staff have any questions concerning this report. Other major contributors to this report are listed in appendix III.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Paul F. Math". The signature is stylized with a large, sweeping initial "P" and a distinct "M".

Paul F. Math  
Director, Research, Development, Acquisition,  
and Procurement Issues



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**Abbreviations**

DCAA	Defense Contract Audit Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DOD	Department of Defense
GAO	General Accounting Office

# DCAA Reports With and Without Examples of Potential Cost Impact

Of 83 DCAA estimating system reports that identified subcontract-estimating deficiencies requiring corrective action, we found that

- 22 included examples of potential cost impact,
- 3 addressed deficiencies, such as policies and procedures, where a potential cost impact could not be cited, and
- 58 did not include examples of potential cost impact.

In table I.1, the 22 DCAA reports that provide examples of potential cost impact are identified by DCAA report number and by GAO control number.<sup>1</sup>

**Table I.1: Twenty-Two Reports With Examples of Potential Cost Impact**

GAO control number	DCAA report number
11	7141-90B24030003
22	7291-8E240016
27	7391-88Q24010164
29	7411-9A240001
32	7171-9E240042
33	7171-9T240038
34	7171-9X240030
55	7331-9G240002
56	7332-9D240001
63	7121-8C240019
68	7361-89J24000308
69	7361-89B24010286
70	7361-89J24010307
71	7361-89B24010285
72	7361-88N24000002
79	7261-89A24010005
96	6141-9J240001
97	6141-9N240001
103	6311-8A240.001
131	6241-9J240101
138	6181-89C24010-050
157	6231-89H24030004-307

<sup>1</sup>For data control purposes, we assigned a unique number to each DCAA estimating system report making up the universe of reports included in our review. Our computerized data base on these DCAA reports was sent to DCAA on June 7, 1991.

**Appendix I  
DCAA Reports With and Without Examples of  
Potential Cost Impact**

Table I.2 identifies the 3 DCAA reports that only cited deficiencies with subcontract-estimating policies and procedures where no potential cost impact could be identified.

**Table I.2: Three Reports Cited  
Deficiencies Where No Potential Cost  
Impact Could Be Identified**

<b>GAO control number</b>	<b>DCAA report number</b>
44	7391-90L24030001
99	6321-9W240001-326
115	6331-9F240001

The 58 DCAA reports that did not provide examples of potential cost impact are identified in table I.3.

**Table I.3: Fifty-Eight Reports Without  
Examples of Potential Cost Impact**

<b>GAO control number</b>	<b>DCAA report number</b>
2	7241-0E240001
3	7241-9C240008-001
4	7381-9E240003
5	7381-9P240005
8	7121-9D240027
9	7251-88K24010311
10	7121-9B240033
12	7481-9A240002(0302)
14	7241-9J240007-001
15	7241-9N240005-001
16	7121-89E24010001
17	7121-9A240015
18	7121-9D240001
19	7151-89C24030038
20	7151-9G240034
21	7251-88H24010433
24	7311-88W24000010(0154)
26	7391-88R24010167
36	7391-88T24010172
38	7391-9A240003-S1
40	7391-89M24000159
41	7391-89N24000110
49	7151-9D240137
52	7151-9M240157
65	7131-9J240047
67	7131-9A240028

(continued)

**Appendix I  
DCAA Reports With and Without Examples of  
Potential Cost Impact**

<b>GAO control number</b>	<b>DCAA report number</b>
88	7251-89A24030990
90	6301-89A24030001.001
95	6141-9E240001
104	6521-89A24010201
105	6521-89B24010701
106	6221-9A240001-374
107	6221-9R240001.382
108	6261-88L24030001
109	6291-88B24000002-202
110	6291-8H240004-9-98
111	6291-89E24030002-391
112	6291-89C24030001-363
113	6291-89D24030001-400
116	6371-9F240001
127	6501-9D240001
128	6531-8B240001-021
129	6531-9A240001-133
136	6151-9H240301
139	6191-9J240189
140	6201-9E240101-379
142	6201-9E240102-391
143	6201-9G240003-370
144	6231-9Q240001-068
145	6231-9R240001-049
146	6251-89A24010001-S1
147	6251-89B240300003
148	6351-8R240002
150	6351-9F240001
153	6361-9A240001
155	6501-9B240001
156	6501-0C240001
158	6411-89C24030001-0220

# DCAA Reports That Did Not Recommend Disapproval of Inadequate Estimating Systems

The 17 DCAA reports listed in table II.1 cited significant subcontract-estimating deficiencies. However, although they concluded that the contractors' estimating systems were totally inadequate or inadequate in some respects, they did not recommend disapproval of the systems.

**Table II.1: DCAA Reports That Identified Inadequate Contractor Estimating Systems but Did Not Recommend System Disapproval**

GAO control number	Report date	DCAA report number
110	01-Mar-89	6291-8H240004-9-98
103	28-Mar-89	6311-8A240.001
34	05-Apr-89	7171-9X240030
33	18-Apr-89	7171-9T240038
63	09-May-89	7121-8C240019
16	05-Jun-89	7121-89E24010001
157	09-Jun-89	6231-89H24030004-307
49	24-Jul-89	7151-9D240137
17	25-Jul-89	7121-9A240015
24	09-Aug-89	7311-88W24000010(0154)
18	21-Aug-89	7121-9D240001
112	31-Aug-89	6291-89C24030001-363
52	22-Sep-89	7151-9M240157
9	27-Sep-89	7251-88K24010311
111	28-Sep-89	6291-89E24030002-391
142	29-Sep-89	6201-9E240102-391
145	26-Dec-89	6231-9R240001-049

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# Major Contributors to This Report

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**National Security and  
International Affairs  
Division, Washington,  
D.C.**

David E. Cooper, Assistant Director  
John L. Carter, Assignment Manager

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**Seattle Regional Office**

William R. Swick, Issue Area Manager  
Neil T. Asaba, Evaluator-in-Charge  
John W. Sisson, Evaluator  
Daniel C. Jacobsen, Evaluator  
Stanley G. Stenersen, Evaluator  
Robert J. Aiken, Computer Analyst

---

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